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Japan's GNP Grew Sluggishly In Second Quarter

Based on gross national product statistics released September 22 the Japanese economy would appear to be suffering a mild ailment at worst. On a price-adjusted annual basis GNP grew in the April-June quarter at a less than robust 1.1 percent. Although by some yardsticks that was an adequate rate of expansion, a closer look reveals that, absent the economic equivalent of artificial respiration, the economy in the spring would have suffered one of the sharpest declines in Japan's postwar history.

The key to understanding the slowdown in Japanese growth is to divide the economy into three components: domestic private sector, foreign trade and government. In the second quarter private domestic demand, consisting primarily of consumer spending plus plant and equipment investment, fell 2.8 percent on an annualized basis. This drop was the sharpest since the fourth quarter of 1974, in the midst of the first oil crisis. A 10.3 percent annualized jump in housing construction broke a string of six straight quarterly declines but carried far too little weight to counterbalance lower consumer and capital spending. Had the rest of the economy treaded water, the value of goods and services would have contracted 2.4 percent annualized, simply from the falloff in private domestic spending.

The decline in private domestic spending suggests that the economy had trouble breathing on its own during the spring. Succor came from growth in the foreign and government sectors.

Japan's Real Gross National Product at Constant (1985) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1990	FY 1991	July-September 1991	October-December 1991	January-March 1992	April-June 1992
Gross Domestic Product	¥406,615.1 (5.7%)	¥420,682.1 (3.5%)	¥420,211.8 (1.7%)	¥420,104.1 (-0.1%)	¥423,807.5 (3.6%)	¥424,568.5 (0.7%)
Gross National Product	409,214.5 (5.5%)	423,591.3 (3.5%)	423,052.8 (2.0%)	422,715.7 (-0.3%)	427,321.2 (4.4%)	428,444.6 (1.1%)
Personal Consumption Spending	234,085.0 (4.0%)	240,669.0 (2.8%)	240,449.8 (3.0%)	240,692.7 (0.4%)	242,895.8 (3.7%)	242,834.4 (-0.1%)
Private Residential Construction	22,848.6 (4.9%)	20,260.8 (-11.3%)	20,620.8 (-9.0%)	19,621.3 (-18.0%)	19,601.8 (-0.4%)	20,086.1 (10.3%)
Private Fixed Nonresidential Investment	88,990.7 (12.1%)	91,642.9 (3.0%)	92,225.3 (2.9%)	91,491.3 (-3.1%)	91,284.0 (-0.9%)	89,062.9 (-9.4%)
Change in Business Inventories	2,901.4 (-20.8%)	3,225.9 (11.2%)	3,420.9 (35.2%)	3,075.5 (-34.7%)	3,263.1 (26.7%)	2,595.1 (-60.0%)
Government Current Expenditures	34,428.7 (2.4%)	35,428.9 (2.9%)	35,114.8 (-5.3%)	35,297.1 (2.1%)	35,700.0 (4.6%)	35,718.0 (0.2%)
Government Fixed Investment	26,095.1 (4.4%)	27,572.8 (5.7%)	27,392.6 (0.2%)	27,655.8 (3.9%)	27,798.3 (2.1%)	29,830.3 (32.6%)
Change in Government Inventories	95.1 (*)	-197.4 (*)	240.8 (*)	-942.6 (*)	91.8 (*)	317.1 (*)
Net External Sector	-230.1 (*)	4,988.4 (*)	3,587.8 (*)	5,824.6 (*)	6,686.4 (*)	8,000.7 (*)
Exports of Goods and Services and Factor Income Received	73,760.4 (7.7%)	77,217.8 (4.7%)	76,671.6 (10.4%)	77,949.8 (6.8%)	79,389.6 (7.6%)	77,042.1 (-11.3%)
Imports of Goods and Services and Factor Income Paid	73,990.6 (7.2%)	72,229.4 (-2.4%)	73,083.8 (11.9%)	72,125.2 (-5.1%)	72,703.2 (3.2%)	69,041.4 (-18.7%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

Although these two sectors together constitute a mere 17.2 percent of Japan's economy, they made up the April-June shortfall in private domestic spending and then some. Public investment, for example, was up a whopping 32.6 percent on an annualized basis. This jump reflected the government's April decision to accelerate public works expenditures by spending around 75 percent of the 1992 fiscal year budget in the April-September period (see *JEI Report* No. 14B, April 10, 1992). By itself this increase would have been sufficient to raise real GNP 2 percent, other factors equal.

Foreign trade was the other positive element in GNP, although in a very incidental way. Price-adjusted exports dropped 11.3 percent in the April-June period, indicating that Japanese companies were unable to export their way out of domestic difficulties. Imports dropped 18.7 percent, more than offsetting the effect of lower exports and lifting GNP significantly. Of course, the falloff in imports merely reflected the weakness of demand generally and cannot be interpreted as a sign of strength in the economy.

The inclusion of an extra day for leap year in the January-March period raised the base against which growth rates were calculated for the second quarter. The rate of change in consumer spending was depressed partly in the April-June period for this reason. However, the 1.8 percent annualized growth of consumer spending during the first and second quarters — a figure that largely eliminates the leap year effect — suggests that personal consumption, supposedly one of the strongest parts of the Japanese economy, was growing very slowly in this year's first half. Recent data indicate that consumer sentiment has continued to weaken, implying that policymakers cannot count on consumers to bail out the economy.

Nor will plant and equipment spending come to the rescue. Japanese policymakers sometimes assume that business investment will revive in response to lower interest rates, even though capital spending has dropped since last October — a period during which interest rates declined. Despite its weakness, private capital spending remained a high 20.8 percent of real GNP in the April-June quarter, several percentage points above its historical average. The best that can be expected is that plant and equipment spending will not go into a free-fall in response to weak domestic and foreign economic conditions.

Conversely, government investment will remain strong, at least for the time being. GNP data for the July-September period, to be released in late December, will continue to reflect the program to accelerate public works. Assuming that the government's large economic stimulus package passes the Diet in a timely fashion this fall (see *JEI Report* No. 36B, September 25, 1992), public works spending will remain robust through the second half of fiscal 1992, which ends March 31. Should the package face significant delay, however, public works spending might make a relatively small contribution to net growth after September.

The foreign trade situation is harder to read. If overseas markets revive, exports may pick up. The yen's recent strength, largely unanticipated, could sharply limit or eliminate profits from foreign sales if it continues at its late September level of ¥120 to the dollar or stronger. Press accounts already suggest that manufacturers are scaling back export plans. Given that overall profits are falling (see following article), Japanese companies may be disinclined to chance further losses in risky foreign markets. In their perverse fashion imports may contribute to economic growth by dropping again, a phenomenon that will bring no joy to trade officials in Tokyo. Analysts worry about both the weakness of domestic demand as implied by anemic imports and about the likelihood of renewed criticism from trading partners skeptical about the openness of Japanese markets.

In short, the outlook for the Japanese economy during the balance of calendar 1992 is for more of the same pattern displayed in the second quarter. Economic expansion by means of government life support technically may lead to reports of reasonable overall growth figures, but the underlying weakness of the economy will remain.

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